CRUX ASSET MANAGEMENT

Fund Manager: Richard Penny

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TM CRUX UK Special Situations Fund

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Market Conditions

Q2 2024 was a strong quarter across the UK market. Small-caps, outperformed significantly from mid-April through May due to a combination of cyclically and historically depressed valuations and improving trading updates, as well as economic data. The IMF upgraded its growth forecast for the UK and large institutions such as HSBC highlighted 'a golden buying opportunity' for UK stocks and UBS moved UK equities from their least to most preferred asset. Markets shrugged off Rishi Sunak's snap election announcement.

As widely anticipated, Kier Starmer became the new Prime Minister with a large Labour majority shortly after quarter-end. Within 72 hours of the election result, the new Chancellor of the Exchequer, Rachel Reeves, set out her vision for "stability, investment and reform". Reeves' plans included a significant increase in housebuilding with a return of mandatory housing targets, a loosening of planning red tape, unblocking stagnant infrastructure projects and the formation of a national wealth fund in a bid to attract international investors. We are encouraged by the cross-party support for unlocking institutional capital for investment in high-growth firms in the UK. The Labour Party appears to be continuing and enhancing the project recently initiated by the previous government.

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We believe that UK small-caps should benefit from an economic recovery and falling UK interest rates, currently expected to begin in August, which should lead to a positive backdrop of attractive valuations and momentum and a reversal of the outperformance of large-cap defensives experienced over the past 2-3 years.

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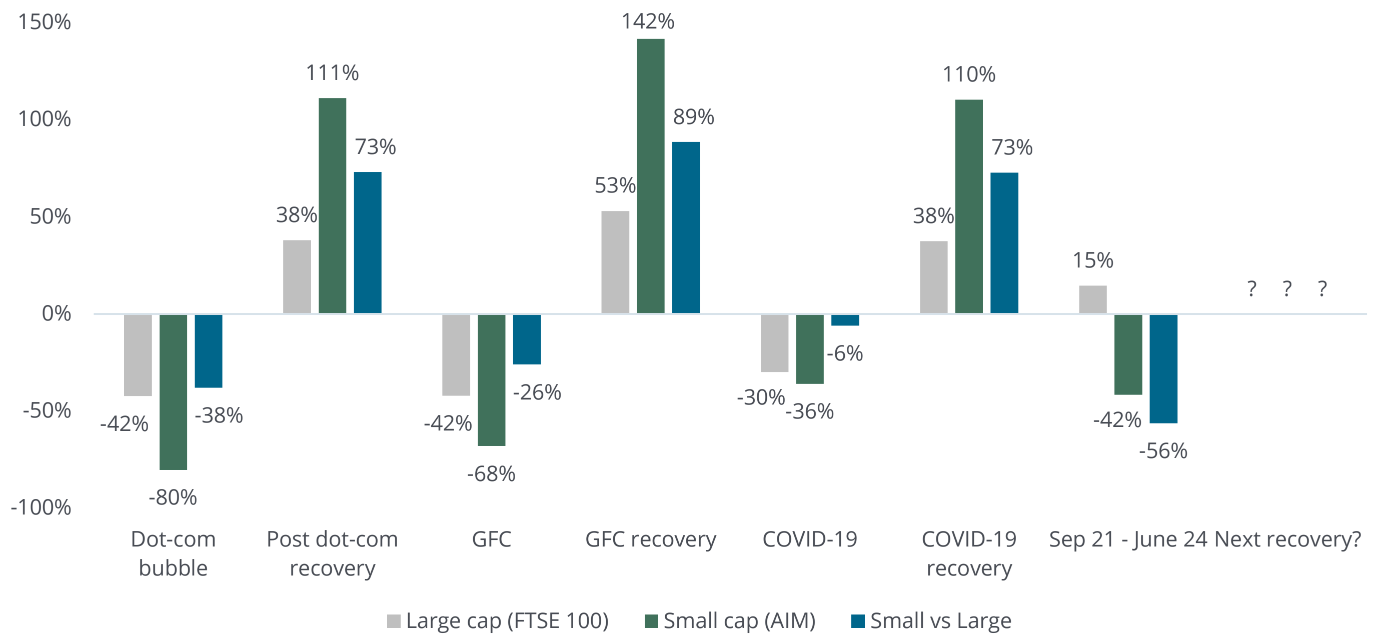
As illustrated by the chart below, the drawdown in UK small-caps experienced since the highs of September 2021 has been the third worst period this century, only behind the bursting of the dot-com bubble and the global financial crisis. However, when looking at the relative performance of small-caps vs large-caps, this recent c.2-3-year period has been significantly worse (dot-com: c.38% underperformance; GFC: c.26% underperformance; and Sep 2021 – June 2024: c.56% underperformance).

UK Small-cap vs Large-cap performance during drawdowns and recoveries



Source: Bloomberg 30 June 2023

The underperformance of small-caps has been driven by a combination of difficult macroeconomic headwinds and 36 consecutive months of outflows, significantly depressing share prices in less liquid names. Macroeconomic data has shown improvement and a simple relief in selling pressure has led to significant performance in some instances.

Although small-caps have turned a corner, it is important to note the potentially significant upside that remains in our view. Despite the FTSE 100 hitting a new all-time high during May, the FTSE AIM All-Share Index remains c.42% below its peak at the end of June with some individual small-caps off c.90%. Although previous highs are not the most appropriate benchmark, some share prices do have the potential to return to these levels and surpass them. In our experience it is not unusual for some individual small-caps to go up many multiples in a recovery.

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Fund Performance

The TM CRUX UK Special Situations Fund (I Accumulation GBP) returned 5.1% against its performance comparator the IA UK All Companies Sector return of 3.9% over the quarter. Performance was led by the Fund's smaller companies, up c.9.5% and outperforming the FTSE AIM All-Share Index which was up c.3.5% over the quarter. The mid-caps within the Fund were up c.4.0%, outperforming the FTSE 250 which was up c.3.2% over the quarter. The FTSE 100 was up c.3.7% during the quarter and the Fund's large-cap exposure also performed strongly, up c.4.5%.

One Savings Bank (OSB) was the largest contributor to performance during the quarter, up c.20% and contributing c.0.7% to the Fund. An in-line update in May was enough to reassure investors following previous downgrades, and disproportionately negative share price reactions in our view. With a c.8% cash return and significant buybacks expected in 2024, we believe investors are being well compensated whilst the shares are valued below book value which is too low in the context of a return on tangible equity of close to c.20%.

Small-cap Jadestone was another strong performer for the Fund during Q2 2024, up c.32% and contributing c.0.6% to Fund performance. The shares benefitted from a higher oil price and strong progress at the Akatara project in Indonesia. Akatara, we believe, has the potential to be transformational for the business, generating significant levels of cash and improving the borrowing base from which management can pursue accretive M&A deals.

Made Tech was another strong performing small-cap during the quarter, up c.109% and contributing c.0.6% to Fund performance. In April 2024, Made Tech announced a material contract expansion with a long-standing customer, The Department for Levelling Up, Housing and Communities, reassuring the market following a soft H1 bookings performance. At the end of June 2024, Made Tech released a strong year-end update, whereby all key metrics were either in-line or ahead of expectations, with further contract wins in June through a renewal and expansion with the Met Office, despite the announcement of a snap election. We believe this bodes well for FY25, where forecasts have been conservatively set on the assumption that trading would be subdued in the lead-up to an Autumn election.

JD Sports was the largest detractor from performance during the quarter, down c.11% and detracting c.0.5% from Fund performance. The shares drifted down at the beginning of the quarter following a positive reaction to an encouraging trading update at the end of Q1. Full year results reported at the end of May pointed to an in-line FY2024 but Q1 FY2025 was slightly weak year-on-year. This was not entirely surprising given the tough comparative. Notwithstanding difficult macroeconomic conditions in the near-term, we believe the low valuation multiple does not adequately reflect JD Sports' strong market position or longer-term growth potential.

IP Group was also a poor performer during the quarter, down c.13% and detracting c.0.4% from Fund performance. The shares have been caught up in interest rate expectations and fund flows for a long period of time. Trading at more than a c.60% discount to NAV appears to be unreasonable, in our view, given recent disposals around NAV, progress in clinical trials at more than 10 portfolio companies, strong revenue growth across its deeptech holdings and technological and funding progress across its key cleantech holdings.

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Transactions

In terms of transactions, Shell was switched for BP during the quarter due to a more attractive valuation. Whitbread was also sold due to weakening momentum following a strong period of pricing gains in 2023.

Small holdings in small-caps Dianomi, CML Microsystems, HeiQ and Sondrel were exited with the proceeds redeployed into preferred names. FD Technologies was sold during the quarter following a rebasing of near-term expectations with respect to the KX Systems business. We believe that significant long-term potential remains and we are likely to revisit the case for a position within the Fund as progress is made on management's strategic review.

Mid-cap Dowlais was added to the portfolio during the quarter. An FY25 P/E of c.4x, a free cashflow yield of c.13% and a dividend yield of c.6.5% suggests an outcome materially worse than the one being reported remains priced into the shares. We believe Dowlais is a prime candidate for a takeover bid if the quality of the business is not adequately reflected in the share price.

A position in TP ICAP was also initiated during the quarter. We believe management's decision to consider a potential IPO of a minority stake in Parameta Solutions, the data and analytics business, could unlock significant incremental value. TP ICAP trades at a P/E of <7x and offers a c.7.5% dividend yield which is c.2x covered by cashflows.

ITV was added to the portfolio during the quarter. We believe that investor sentiment towards the shares has been heavily skewed towards its cyclical advertising sensitivity for some time and the progress made in its increasingly important production operations has been overlooked. Additionally, based on updates from smaller peers, advertising demand for the Euros football tournament appears to be significantly ahead of initial expectations.

Molten Ventures and SSP Group were also added to the portfolio during the quarter. Molten Ventures issued strong results for FY2024 noting average core portfolio revenue growth was in excess of 50% with 85% of the core portfolio having at least 18 months of cash runway as of the end of March. Realisation visibility of £100m and a 10% share buyback provided further reassurance on the strength of the balance sheet.

SSP Group was added following what we believed to be an overly pessimistic market reaction to the half year results announced in May. Top line growth has been impressive, but it has not translated into positive earnings momentum, possibly due to FX headwinds, heightened seasonality, post-Covid capex catch-up and train strikes. We believe these factors should abate over the next 12 months and with the shares trading at record low valuation multiples, we view this as an attractive opportunity.

Outlook

We believe that with the underperformance of small-caps relative to large-caps being at historic levels in the UK, 36 consecutive months of outflows depressing share prices and being on the cusp of UK interest rate reductions and an economic recovery sets up the potential for an strong phase of performance for the TM CRUX UK Special Situations Fund.

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As discussed at the beginning of the update, the underperformance of small-caps vs large-caps experienced since September 2021 to June 2024 has been worse than the underperformance experienced during the bursting of the dot-com bubble, the global financial crisis and COVID-19. Following the bursting of the dot-com bubble, the FTSE AIM All-Share went up c.111% over a c.2-year period and outperformed the FTSE 100 by c.73%. Following the global financial crisis, the FTSE AIM All-Share Index went up by c.142% and outperformed the FTSE 100 by c.89%. Following the COVID-19 low, the FTSE AIM All-Share Index went up by c.110% over a c.1.5-year period and outperformed the FTSE 100 by c.74%.

Fund's managed by Richard Penny have historically outperformed significantly during economic recoveries. Recent examples include the L&G UK Alpha Trust returning c.173% trough to peak following the Global Financial Crisis in 2008/2009, outperforming the IA UK All Companies Sector by c.88% and the TM CRUX UK Special Situations Fund returning c.151% trough to peak following the COVID-19 pandemic, outperforming the IA UK All Companies Sector by c.75%, with significant performance coming from small-caps.

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